

MINERALS MANAGEMENT SERVICE

ensuring value

building consensus

staying responsive



As a small agency born of reinvention, we are continually exploring better ways to serve our customers and bring value to the American taxpayer. Managing America's vast, but still finite, mineral resources with an eye on the future requires ever-increasing efficiency and creativity. This report highlights our work over the past year to identify and implement improvements in everything that we do.

Where We Began

From the first Native Americans to the European explorers to the Western pioneers, people have always recognized the immense importance and value of America's natural resources.

What most don't realize, however, is the vital role the federal government plays in ensuring the proper fiscal accountability and management of these assets.

In 1982, the U.S. Department of the Interior established the Minerals Management Service to best administer America's mineral resources. We were given the mission of managing the oil, natural gas and other mineral resources on the Outer Continental Shelf (OCS) in an environmentally sound and safe manner and, in a timely fashion, collecting, verifying and distributing mineral revenues generated from federal and American Indian lands.

MMS developed two operational programs to carry out that mission—Offshore Minerals Management and Minerals Revenue Management (formerly known as the Royalty Management Program).

Together these provide major economic and energy benefits on a national and local level to the taxpayers, states, and the American Indian community.

Since our creation MMS has distributed approximately \$110 billion to federal, state, and American Indian accounts, including:

- \$69 billion to the U.S. Treasury
- \$26 billion to the Land and Water Conservation Fund, the National Historic Preservation Fund and the Reclamation Fund
- \$12 billion to 38 states
- \$3.1 billion to the Department's Office of Trust Funds Management on behalf of 41 Indian tribes and 20,000 individual Indian allottees.

The Outer Continental Shelf significantly contributes to our energy supply, providing about 143 trillion cubic feet of natural gas and 13 billion barrels of oil to the nation since 1953.

Industry has learned to look deeper and deeper. Titusville, Pennsylvania in 1859 was the setting for the first well drilled specifically for oil. Almost 80 years later, the first well was drilled in the Gulf of Mexico at Creole Field. Only 17 years ago, the first oil was produced from beneath 2,000 feet of water. Today, wells are being drilled in over 8,000 feet of water.





While MMS does enforce regulations, we also employ proactive tools, such as our award program, to encourage responsible operations. We reward companies whose operations are exemplary in terms of both safety and accurate, timely payments. A characteristic openness distinguishes our nomination process (for example, MMS staff from all ranks can nominate worthy potential recipients).

Where We Are Today

Currently, MMS handles more than \$5 billion per year in revenues from federal offshore mineral leases and from onshore mineral leases on federal and American Indian lands. The complex national energy picture means that MMS activities and responsibilities affect a wide array of stakeholders, all of whom we consider our customers. For example:

- industry acquires and operates offshore leases which provide about a quarter of all domestic natural gas and oil; **our Offshore program monitors and works to maintain the safety of these operations.**
- we collect billions of dollars in royalties, bonuses, and rentals from industry for natural gas, oil, coal and other solid mineral leases.

- states and local communities share in federal royalties and advise us of the impact of oil and natural gas operations in their areas.
- environmental groups work to ensure that environmentally sensitive areas are not jeopardized.
- American Indian tribes and individuals receive mineral royalties collected by MMS as part of the Department of the Interior's trust responsibilities.
- federal mineral receipts are largely reinvested in ways that improve the quality of life for all Americans (funding parks, education, historical sites, etc.).

To help us build consensus and balance the interests of our diverse stakeholders, MMS emphasizes customer service and participation as well as an abiding commitment to open communication.



Where We're Going Tomorrow

MMS's vision is to be recognized as the best minerals manager in the world.

To achieve this vision we focus on:

- commitment to **safety** in exploration and operations
- sensitive stewardship of the **environment**
- assurance of **fair market value** for these nonrenewable resources
- exploration of **creative solutions**
- providing **fast access to funds** for all revenue recipients
- timely, accurate **compliance** from mineral producers
- dedication to our **American Indian trust** responsibilities.

Accordingly, for this report we have arranged our findings on the accomplishments and results of MMS's work toward achieving our goals in each of these areas, particularly how they impact our stakeholders. A com-

mon thread throughout our review is the forward thinking and adaptability we bring to our work. **For example, a number of the stories within highlight our efforts to make more of our information and services accessible online.** This review embodies our commitment to build a better agency and fulfill our vision.

For more detailed information on MMS's fiscal year 2000 performance and to see our 2000–2005 Strategic Plan, see the "Strategic Planning" section at <http://www.mms.gov>.

For more statistical information on the many energy and economic benefits MMS provides, please see our new booklet, *MMS Facts and Figures 2000*. It is also available on our website.

MMS's new "Instant Information" website—www.mms.gov—provides a comprehensive, searchable database for current and historic federal and American Indian mineral leasing and revenue statistics. Customers can immediately access the online data and sort it by categories of their choice, including years, states, leases, commodities, dollars, etc. Within three years, this site will include historic data as far back as 1920.



OFFSHORE MINERALS MANAGEMENT



Soaring prices at the fuel pump and to heat our homes underscore the importance of developing the nation's energy sources. **Demand for energy, particularly natural gas, is expected to increase substantially in the future.** Current natural gas usage is at 22 trillion cubic feet (tcf). Natural gas demand in the U.S. could reach as high as 28 tcf by the year 2010 and 35 tcf by 2020, a large increase that the nation will have to somehow meet. Already operations in the federal waters off America's shores significantly contribute to the national energy supply, providing more than 26 percent of the natural gas and 25 percent of the oil produced in the U.S. MMS balances the critical search for offshore energy and mineral resources with the protection of the human, marine and coastal environments.

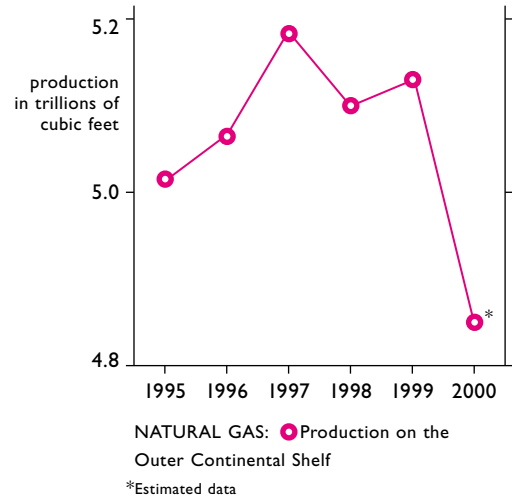
MMS's Offshore Minerals Management program has jurisdiction over approximately 1.76 billion acres of the Outer Continental Shelf, on which there are about 7600 active leases on 40 million acres.

MMS prepares and maintains five-year oil and gas leasing programs mapping out the size, timing and location of leasing activity determined to best meet national energy needs. **We have just begun the in-depth process required to develop the program for 2002–2007, which will enable our stakeholders to plan ahead for the proposed offshore lease sales.**

The five-year plans are developed in an open and candid manner to achieve consensus-based decisionmaking supported by sound science, recognizing trends in energy production and use and considering environmental impacts.



We always keep an eye out for innovations, and operations in the Gulf of Mexico never cease to amaze. The Gulf is the scene for a number of impressive technological feats, including the world's tallest freestanding structure (a tower which rises 2,000 feet from the sea floor) and the world water depth record for an exploratory well from an anchored rig (7,790 feet).



MMS is working to tie together all of these sprawling concerns—safety and environmental regulation, national energy concerns and international outreach—using our Technical Information Management System (TIMS) which will:

- provide consistent, reliable data for the analysis of safety and environmental trends, impacts and issues
- keep pace with the technology being used by industry to acquire and analyze geological and geophysical data
- enable MMS to make better, more efficient estimates of monetary values

A likely component of the 2002–2007 plan will be further exploration in the deepwater Gulf of Mexico. In 1995, the Deep Water Royalty Relief Act offered financial incentives designed to advance interest in leasing, exploration and development of the deepwater Gulf. In addition to extending incentives (as mentioned in the Fair Market Value section below), MMS is partnering with the Department of Energy to help further the development of technology for ultra-deepwater oil and gas production in the Gulf of Mexico.

Each advance in this new frontier spurs further challenges for MMS. For example, it has become increasingly more important to define the boundaries of an area called the “Western Gap.” **This is one of the regions of the Gulf outside the established boundary between the U.S. and Mexico (originally set out to 200 miles) which has required the attention of MMS and the U.S. State Department.**

Of course the global nature and impact of the minerals industry means that MMS reaches out beyond our neighbors to the whole international community. To ensure a cleaner environment and safer operations worldwide, we help other countries to modernize with efficient, effective regulatory practices. MMS’s expertise has been sought by other countries, including Bangladesh, China, India, New Zealand, Norway, Russia, Turkmenistan and a coalition of governments from Asia. **We also work on the development of international standards.**



Habitats and hazards know no national boundaries. A vital part of the effort toward a safer work environment globally, MMS works on safety standards issued by international organizations for offshore oil and gas regulatory programs. For example, the international standard specifying the minimum acceptable requirements for subsurface safety valve equipment is considered the last line of defense in securing a well and preventing pollution.

Negotiations to determine the boundary began in 1998, with the U.S. and Mexico signing an agreement treaty on June 9, 2000. This is important as areas of the Gulf once thought beyond reach are now being explored and developed successfully.

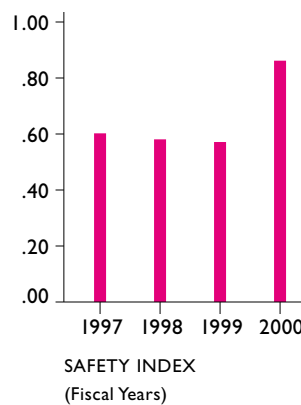


SAFETY

Charting unknown waters and working in unfamiliar territory always carries an element of risk. While MMS encourages brave thinking, we do so only while insisting upon safe operations. **In addition to proactively alerting operators to risks, we conduct extensive inspections and enforce compliance with safety regulations.**

Each year we hold personalized performance meetings with selected offshore operators in the Pacific and in the Gulf of Mexico. These face-to-face meetings afford invaluable insights into the issues facing offshore operators and open dialogue with MMS. Operators working in federal offshore waters also report all serious accidents associated with operations on a lease. **MMS tracks reported accidents in a database and closely monitors and analyzes incident data for emerging trends.** When we spot them, we bring them to the attention of all operators.

To help track our performance in meeting the crucial safety goal, MMS analysts looked at the various streams of safety information coming in from the field and devised an index as a relatively quick gauge of overall safety in offshore operations. We are reviewing the component data (e.g. fatalities, property damage, etc.) and discussing results with industry. Once we have a better understanding of the root causes, we will work with industry to improve safety even more.



We saw a rise in the safety index in 2000 after several years of progress in reducing the index. We believe the rise may be due to an increase in the number of severe injuries offshore and to including more actual property damage reported by operators, rather than estimates.



Year-to-date totals for inspections, incidents of noncompliance and enforcements.

INSPECTIONS

Abandonment	41
Accident Investigation	28
Completion	175
Drilling Facilities	1,555
Environmental	382
Flaring	314
Hydrogen Sulfide	28
Metering	4,169
Other	42
Pipeline	6,816
Production Facilities	4,823
Workover	223
Total Inspections	18,596

INCIDENTS OF NONCOMPLIANCE/ ENFORCEMENTS

Platform Component Shut-Ins	2,374
Platform Shut-Ins	178
Platform Warnings	2,161
Rig Component, Shut-Ins, Warnings	148
Pipeline Component, Shut-Ins, Warnings	3
Well Component, Shut-Ins, Warnings	39
Total Enforcements	4,903

Maintaining safety while conducting exploration and production operations is certainly no small task. Drilling and production activities have accelerated greatly over the past several years in the deep waters of the Gulf of Mexico. This move into greater depths has presented many operational and technical challenges, including:

- pipeline installation and repair
- design and reliability of new production systems
- hydrate and paraffin control
- new mooring systems.

Industry and MMS have responded with numerous research projects to address safe deepwater development, including:

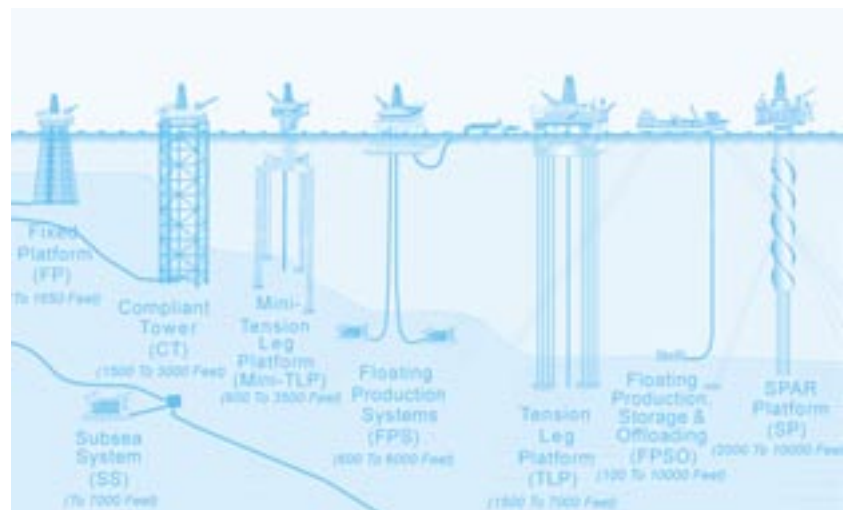
- studies on the reliability of deepwater blowout preventers
- a joint project with industry to develop a procedure to assess the lifetime risk and reliability of subsea production systems
- a cooperative project at Texas A&M University developing tools to compare the risks of existing offshore systems with new technologies.

A promising technology being explored by MMS and industry is the viability of floating production, storage and offloading systems (FPSO) in the Gulf of Mexico. **Allowing production to be stored in a large tanker and using a shuttle tanker to ship the oil to ports, this system is economically attractive to industry for deepwater operations.** Worries about long-term storage risks have prompted MMS and the U.S. Coast Guard to issue a final environmental impact statement, begin the necessary safety and technical reviews

with operators and run comparative risk assessments versus other deepwater production systems.

The burden of proof rests on the operators to show that FPSOs are as safe as other alternatives. Pending a final decision, MMS is working on changes to include the FPSO technology in current regulations.

This illustration of deepwater development systems shows how flexible FPSOs (second from the right) can be.



ENVIRONMENT

One of our most important functions in the Minerals Management Service is keeping an eye on the big picture. Just as our safety goal emphasizes the well-being of the men and women involved in offshore mineral development, our environmental goal focuses our efforts to ensure that the overall health of human, plant and animal environments are protected. **We work in partnership with stakeholders who are involved with, or affected by, offshore activities.**

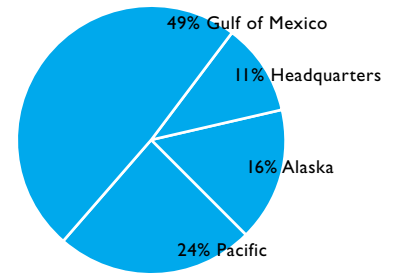
Embodying our commitment to natural resources stewardship, **MMS conducts environmental studies to provide the sound science necessary to consider environmental impacts and to develop measures to minimize adverse effects.**

For example, in 2000 we employed sophisticated deep diving manned and unmanned systems to investigate deep-water biological communities.

Our exploratory efforts have led us to discoveries such as strong deepwater currents and new species. We are opening promising doors for future directions, including aquaculture and investigations of methane hydrates as a potential fuel source.

To track our success in meeting our environmental goal, MMS continues to work on an environmental index to measure the impact of offshore activities. The index will incorporate data on seafloor resources, air quality, water quality and protected biological resources, including endangered species and threatened species and protected marine mammals. A key component of measuring adverse environmental impacts is the oil spill rate for offshore operations. Although we have not completed our investigations of two spills that occurred in January 2000, preliminary data indicate that they were significant enough to preclude the achievement of this goal this year.

Home to the most northern coral reefs in the Gulf, Flower Garden Banks is located 107 nautical miles off the southeastern Texas coast. We protect the reefs and their ecosystems through a stipulation in each of the oil and gas leases in the vicinity which demands that operators take precautionary measures and refrain from certain activities while working near the reefs.



FY 2000 Budget for Environmental Studies

Deepwater issues dominate our research in the Gulf of Mexico, which in turn commands almost half of the total \$19.4 million Environmental Studies budget. Besides deep water, Gulf research addressed air quality, socioeconomic issues and physical oceanography in the north-east Gulf of Mexico.





Photo: Gregory S. Boland

The past year demonstrates the importance of MMS's unflagging commitment to work on oil spill prevention and mitigation. For example, with the push toward deep water, MMS is learning how to deal with the challenges presented by this new environment. In June 2000, MMS and 23 oil companies conducted experiments off Norway's shore to learn exactly how oil spills behave in the high pressures and low temperatures of deep water. We also studied the effectiveness of aerial surveillance technology in tracking the spill while still beneath the surface. What we learn from these studies could be used to guide clean-up efforts in the unlikely event of an accidental release during actual drilling and production operations.

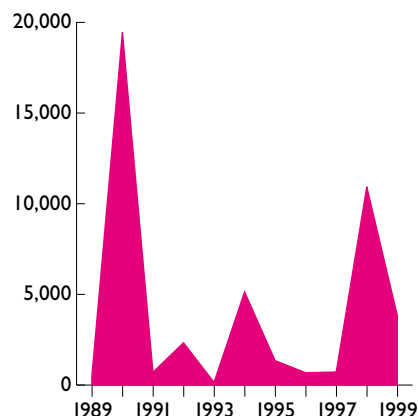
MMS, the National Marine Fisheries Service and the Navy worked together to measure ambient noise in the sea and the sound levels received by tagged sperm whales. Further study needs to document sperm whale communications as well as whale reactions to air guns used in seismic surveys.

In addition to paying attention to the potential environmental problems involved with operating offshore, MMS is also dedicated to exploring the unique opportunities afforded by offshore operations. **The Ocean Studies Board report "Turning to the Sea: America's Ocean Future" recommends tapping the enormous potential of marine species for developing new pharmaceuticals and biomaterials, and applying the tools of biotechnology to restore and monitor the marine environment.** The report expresses a concern, however, about the lack of information to assess the potentially harmful impacts of biotechnology.



Photo: Gregory S. Boland

A slow-growing bryozoan, *Bugula neritina*, may contain an important drug which is active against leukemia. Similarly, a symbiotic bacteria in bryozoans produces bryostatin, a compound which combats the growth of cultured cancer cells.



Total barrels of oil spilled in the federal Outer Continental Shelf

In 1999, over 500 million barrels of oil were produced on the Outer Continental Shelf; about 3,800 barrels were spilled.

In response, MMS is investigating the potential benefits of an untapped marine resource that would not impact the natural environment, namely the luxuriant biological growth that occurs on the underwater structures of offshore oil and gas production platforms.

These “steel pinnacles” act as artificial reefs mimicking the complex marine ecosystem reaching from the seafloor to the intertidal zone. Our partners in this research are the joint MMS-State Coastal Marine Institutes at the University of California at Santa Barbara and Louisiana State University.

This isn't the only benefit MMS has discovered from its attention to offshore resources. The federal Outer Continental Shelf has extensive resources of sand and gravel. **MMS has been examining this as a potential source of sand to support states' beach nourishment projects.** Loss of sand from beaches is a serious problem affecting the environment and economy of some coastal states. For example, one-third of Florida's beaches are severely to critically eroded. Beaches are vital for the state, having a \$15 billion impact on tourism (Florida's number one industry). Given this critical need, MMS made 600,000 cubic yards of federal offshore sand available to Patrick Air Force Base in Florida to protect facilities and island evacuation routes along 3.1 miles of Atlantic shoreline against storm surges, high wave conditions and beach erosion.



We also conduct environmental studies to support the sand initiative of our Marine Minerals Program. A geologic investigation in federal waters out to 10 miles offshore of the central Atlantic coast of Florida was finished in June 2000. The report documents four previously unrecognized areas with potential accumulations of beach quality sand.

MMS and our partners are collecting information on the genetics and taxonomy of selected species on several platforms and will conduct initial laboratory testing of these species for such active compounds as cancer inhibitors, immunosuppressants, anti-inflammatories and commercial bioadhesives.



FAIR MARKET VALUE

MMS collects approximately \$3.5 billion each year from the offshore leases we manage. The revenues come from bonuses paid by winning bidders on auctioned leases and rents and royalties on leases.

Given their nonrenewable nature, America's mineral resources must yield a fair return for the nation. The only way to ensure that we are receiving fair market value for our leases is to make ourselves as knowledgeable as industry with regard to estimating the value of offshore land tracts. **In assessing the wide range of lease tracts in offshore lands as diverse as the Gulf of Mexico and Alaska, MMS has to deal with a staggering array of technological variables.**

This requires a considerable investment in technology, but it certainly has paid off.

Two offshore oil and gas lease sales were held in 2000—Sale 175 in the Central Gulf of Mexico and Sale 177 in the Western Gulf of Mexico.

Tracts where bids were previously rejected tend to get higher bids when re-offered and this proved to be the case in the two Gulf of Mexico sales in 2000.

As our evaluation technology and expertise continue to become more sophisticated we likewise are increasing our understanding of how to ensure that the public receives a fair return for the nation's offshore resources. **This in turn enables us to ensure fair market value as industry explores and develops in new frontiers such as hostile environments, difficult locations and deep water.**



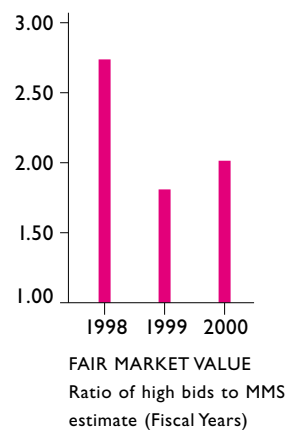
Representing extremely different conditions than operations in the Gulf of Mexico, the Northstar project in Alaska's Beaufort Sea involved the creation of a gravel and ice island for drilling. Development in these challenging conditions has the potential to recover approximately 175 million barrels of oil reserves.

SALE 175	
# of tracts*	15
bids in Sale 172	\$12.69 million
bids in Sale 175	\$60.05 million
increase	373%

SALE 177	
# of tracts*	5
bids in Sale 174	\$1.39 million
bids in Sale 177	\$7.45 million
increase	436%

* tracts that had high bids rejected in the previous Central Gulf of Mexico sales receiving accepted bids in 2000

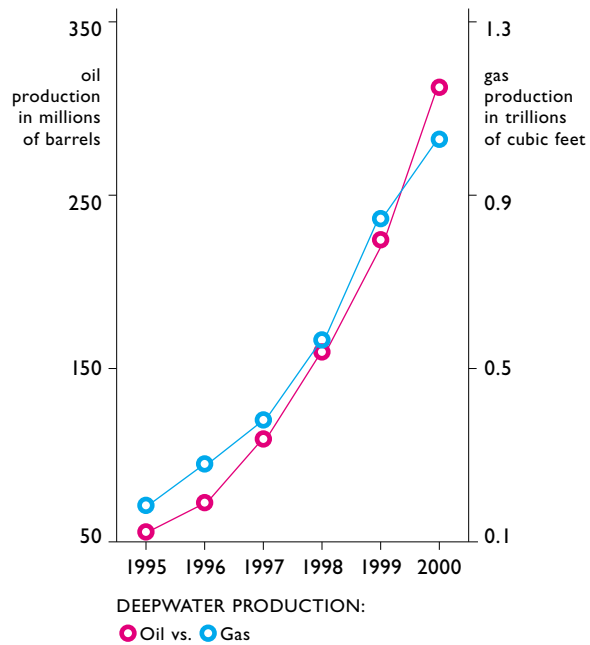
In 2000 we met our fair market value goal (a ratio of $1.8 \pm .4$), which we measure as a ratio of the high bids we receive for offshore leases to our estimate of their value.



Though some provisions of the deepwater relief have officially expired, MMS is still authorized to provide incentives.

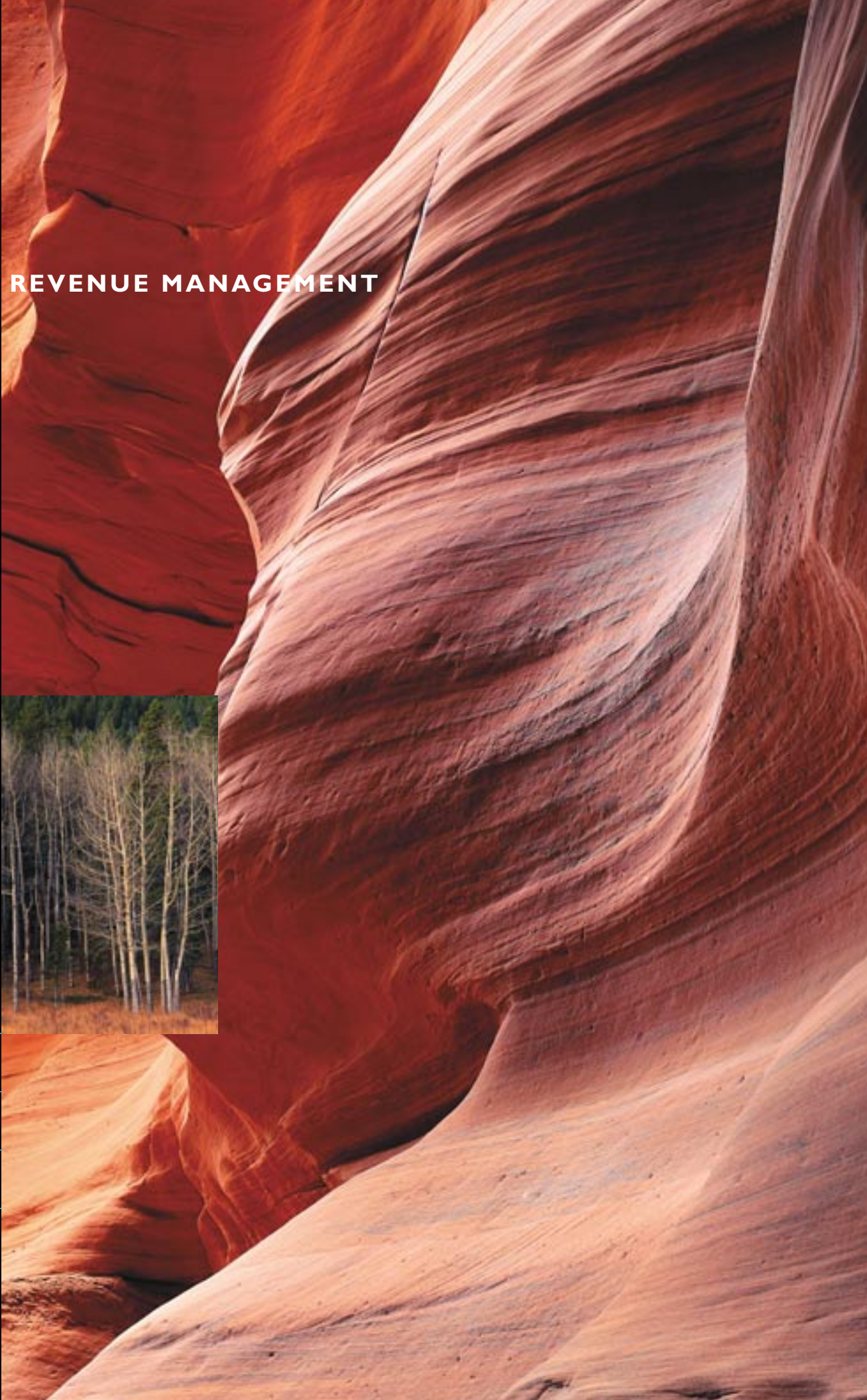
For example, MMS recently began evaluating royalty relief for lease applications that do not fit neatly into the categories previously designated for the relief program. MMS also has revised the regulations for consideration of royalty relief on new leases issued in sales after 2000 in deep water.

The newest sale (Sale 178 in the Central Gulf of Mexico) provides incentives for deepwater natural gas and oil production, and for natural gas from shallower waters.



In November, MMS announced two initiatives to increase domestic natural gas production: a royalty suspension incentive to drill for deep gas deposits in the Gulf and extending lease terms as an incentive to drill for natural gas below the Gulf's thick subsalt layers.

MINERALS REVENUE MANAGEMENT



To the average weekend explorer setting out for a hike through a national forest or local park, high-tech undersea and underground mineral operations would be the furthest things from his or her mind. However, it's the revenues MMS collects from these operations that help preserve our nation's wilderness treasure and make enjoying it all possible. In 2000, MMS collected \$7.1 billion generated from mineral production on federal and American Indian lands. This is the federal government's major source of funding to purchase parks and recreation areas and to plan, acquire and develop land and water resources for recreational use, habitat protection, scenic beauty and biological diversity.

Our work doesn't always involve cutting-edge technology though. Given our emphasis on customer communication, sometimes it's a case of searching for just the right words. In 2000 we changed the name of our Royalty Management Program to Minerals Revenue Management (MRM). This name change is just the tip of the iceberg and an important signal of a major shift at MMS, namely our massive reengineering effort to streamline and improve financial and compliance operations.

Minerals Revenue Management is responsible for ensuring all revenues from federal and Indian mineral leases are accurately collected and disbursed to appropriate recipients in a timely manner. We are reengineering our core business processes and automated support systems to keep up with changing energy markets, legislative mandates, aging com-

puter systems and customer expectations. Our new financial, compliance and asset management system, a data warehouse and other information technology will enable us to remain cost-effective and become even more responsive to customer needs.

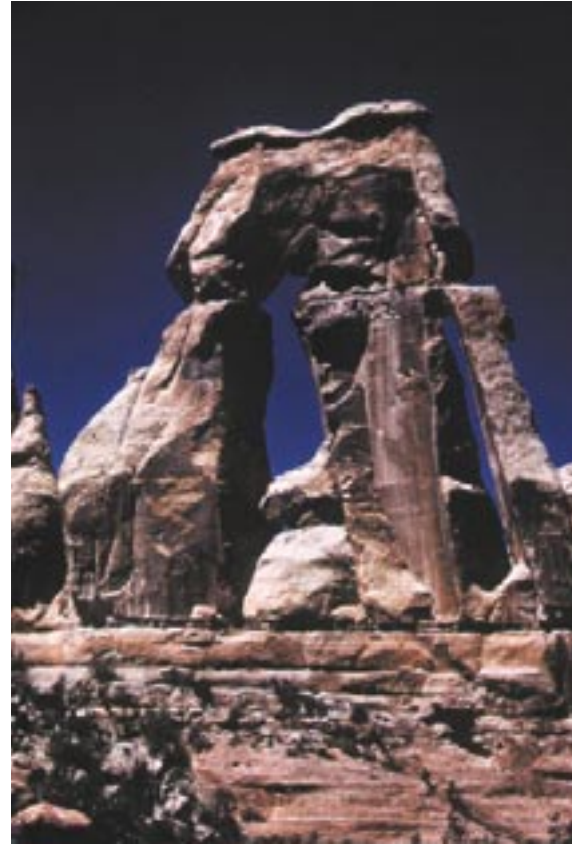
Retooling our staff's skills, this year we reorganized to a process-centered approach that allows us greater flexibility and responsiveness. We aligned both resources and operations under the new structure to implement our reengineered way of doing business. Training for the transition is equipping MRM staff with in-depth knowledge of business practices, transportation, mineral properties and other areas.



Likewise, our royalty-in-kind projects are providing MMS employees with the opportunity to learn new skills: auditors, engineers and accountants, for example, are learning about how to sell federal production in the marketplace. In addition to fostering partnerships and improving understanding between MMS and industry, this training helps us make better decisions about managing the public's assets.

We also engaged our staff and stakeholders in an open discussion to revamp our mission goals in light of the reengineering changes. Our staff's well-spring of experience with prior measures was invaluable in determining how best to properly measure future performance. Implementation of the reengineered processes and systems begins in October 2001 and we expect all reengineering concepts to be fully implemented by 2003.

In keeping with our focus to expand and simplify our customers' access to information, we were among the first to develop a system able to scan, fax, index, store and retrieve documents electronically to respond to Freedom of Information Act requests. Frequently requested information is published at www.mms.gov to provide even wider access, including data on collections, disbursements, state mineral summaries, sales volumes and values and MRM operations and program activities for 1993-99.



CREATIVE SOLUTIONS

Of all the lessons we've learned, the greatest one is to never rest on our laurels. Expert as we are in resource management, we recognize that there is much to learn from the successes of other resource managers. **As evidenced by our GovWorks operation, our agency has a natural entrepreneurial inclination and an appreciation for the business world's innovations in managing financial and market resources.**

We look to model business practices that have made companies winners.

For example, businesses work to find service and product offerings that match their strengths and goals with customer needs. MMS has found one such promising match in royalty in kind (RIK). **We now are actively exploring taking oil and gas royalties from producers in kind (i.e., a percentage of the product) rather than in value (a percentage of the monetary receipts).**

RIK is one tool in our chest for making good decisions on how we manage the nation's royalty assets. Last year, approximately \$1 billion of our royalties were in kind.

In 1997, an MMS feasibility study concluded that, under the right conditions, RIK programs could generate additional revenues and be more efficient for both government and industry. The study led to a series of pilot projects by MMS which are intended to determine:

- the circumstances (market conditions and key success factors) in which RIK makes good business sense
- if the government (and industry) can save money by reducing the cost and burden of collecting royalties
- if RIK can provide accurate, simple and certain royalty collection
- if RIK can create value (revenue enhancement or neutrality) for the taxpayer.

Success in our line of work depends largely on our finely tuned administrative processes, which are so exemplary that other government agencies look to us for help. For example our GovWorks service handled \$249 million in contract work for other agencies last year (up from \$5 million when it began in 1996).



RIK projects also are contributing to our nation's energy supply at the strategic level. By October 31, 2000, MMS transferred 28 million barrels of royalty-in-kind oil from the Gulf of Mexico to the Department of Energy to replenish the Strategic Petroleum Reserve.

In 1998, MMS and the State of Wyoming initiated an onshore pilot for crude oil from federal leases in the Powder River and Big Horn Basins of Wyoming that was eventually moved from a pilot to an Operational Project.

A Texas natural gas project also was initiated in 1998 for federal leases in the Gulf of Mexico. In partnership with the Texas General Land Office, MMS explored ways to cost-effectively market federal RIK gas from nearshore Texas to additional purchasers. Some of the gas was also delivered to the General Services Administration (GSA) for sale to federal facilities.

A third RIK pilot project for natural gas from federal properties in the Gulf of Mexico began in 1999. It was larger and more comprehensive than the other two. In addition to selling the gas competitively to the public, a portion of the gas was also transferred to GSA for sale to federal agencies.

To address the feasibility of taking royalty crude oil from federal properties in the Gulf of Mexico, a fourth RIK pilot project began in 2000. This offshore oil pilot makes the federal royalty crude available, under public competitive sales, to a broad range of qualified bidders. The success of these pilot projects has led MMS to add RIK as another viable option for collecting royalties.

The immediate benefits of the expertise gained from our RIK projects can be seen in improvements made to the small refiner RIK program. Established to provide small refiners with a reliable supply of inventory at equitable prices, in 2000 the small refiner RIK program began two contracts covering 17 offshore Pacific leases and three contracts covering 348 leases in the Gulf of Mexico. Selling the royalty oil through a competitive bid process provides price certainty for refiners. Charging a fair market value for the royalty share achieves the RIK program intent to create a more level playing field in the industry.



“We certainly appreciate this new and refreshing approach to partnering with the State regarding the federal royalties we both share. We are extremely pleased with this change in Minerals Management Service approach and attitudes.”

Michael Geesey, director of Wyoming's Department of Audit

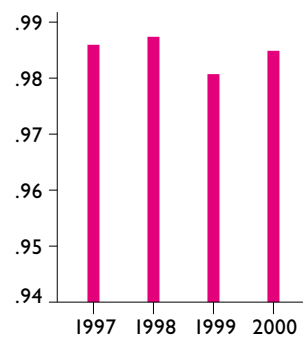
FAST ACCESS TO FUNDS

MMS must use sophisticated computerized accounting to collect, disburse, and report monthly payments on the thousands of leases in our care. To ensure reliable and timely disbursements, one of our main goals for the reengineering initiative is to streamline and modernize our funds delivery to match the best industry practices. We are encouraging electronic production and royalty reporting to save both time and money. Our rule requiring electronic reporting except in hardship cases became effective November 1, 1999. (The exceptions are designed to minimize the impact that electronic reporting might have on small businesses.) Increased automation permits more efficient processing of business transactions by drastically reducing the amount of paper and eliminating non-value-adding tasks common to traditional workflow processes.

The number of companies reporting electronically increases each month by approximately 100 reporters. We awarded a contract to Harbinger Corporation in 1999 to develop, implement and operate a commercial-off-the-shelf electronic reporting system. This system began operation in January 2000. It provides companies that report production or royalties with secured means of transmission. By the end of December 2000, Harbinger Corporation had converted about 1,250 companies to electronic reporting. **These efforts are already paying off. In 2000, the percentage of the collected dollars and accompanying information that is provided timely to states and Indians is over 98 percent, exceeding our target.**



Majestic national parks and wilderness areas may seem timeless, but their preservation requires speedy turnaround of the funds MMS collects.



REVENUE DISBURSEMENT
Percent of revenues disbursed within one month of receipt—our goal is 98 percent (Fiscal Years)

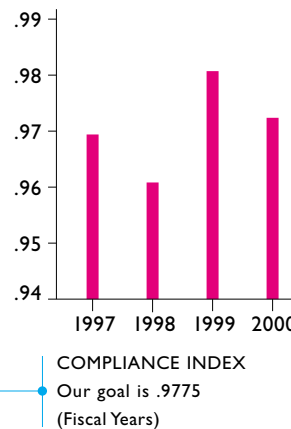
COMPLIANCE

Ensuring accurate and timely compliance for all leases is crucial to our efforts to obtain fair market value and disburse funds quickly to recipients. Compliance for the majority of leases is currently on a six-year cycle, but by working with industry we are moving to an improved three-year cycle. States, tribes and industry participated in five operational model teams—offshore, onshore oil and gas, solid minerals, geothermal and Jicarilla Tribe—that were the foundation for program-wide implementation of the reengineered compliance and asset management process. In 1999 these teams began to define, apply and test the three-year property focused compliance process in a real-world setting. We are continuing to convert properties into the new three-year process until we are fully transitioned in 2003, when compliance reengineering is wholly implemented.

A major challenge we face in ensuring compliance is that mineral lessees can correctly value production for royalty purposes. Mineral valuation is complex, particularly in situa-

tions such as sales to affiliates, changing market conditions and deregulation of natural gas pipelines and electric utilities. To help clarify the situation, MMS's federal oil valuation rule went into effect June 1, 2000. The rule simplifies and improves the procedures for determining the royalty value of oil produced from onshore and offshore federal leases. We will soon be publishing a new rule for valuing oil produced on American Indian lands.

As with some of our other complicated goals, MMS works to get a handle on the compliance picture by compiling data to form an index. The compliance index measures actual voluntary royalty payments against expected royalty payments. **In 2000, we did not quite achieve the compliance index that we had hoped for.** We are now refining the index to better reflect what we have learned about compliance from the operational models.



MMS issues orders and demands to companies to correct significant noncompliance. Another measure of our compliance effectiveness is whether all orders and demands that should have been issued have in fact been issued. Because of an unanticipated nine-month delay in delivery of an automated prototype system, we are behind in meeting this year's goal.

MMS endeavors to work cooperatively with our industry partners to resolve disputes before taking action. We sent letters to companies and spoke with them personally to resolve several compliance issues. Only when we couldn't reach resolution through these preliminary efforts did we proceed to issue orders.

Since the inception of our compliance efforts in 1982, MRM has identified and collected an additional \$2.5 billion in royalty revenues resulting from underpayments. The compliance detection program includes targeted audits of royalty payors and other detection programs that rely on automated systems. **We have formal agreements with ten states and eight American Indian tribes who conduct audits of federal lands within their state boundaries or tribal lands.**

We work with our stakeholders in other ways to enhance compliance processes. In 2000, a joint development team was established comprising MRM employees, state and tribal representatives, and Accenture (our contractor designing and developing our new reengineered systems). The team approach will enhance and refine our compliance processes by fostering knowledge sharing, optimizing communication, and managing project costs to design and build the new processes and information systems.



“The proactive efforts of the MMS to recognize the coal seam natural gas royalty issue in New Mexico and work as a team with the New Mexico Federal Royalty Audit Program to resolve this federal royalty issue has significantly streamlined our audit efforts and the enforcement, settlement, and appeal processes. This effort and initiative truly shows that communication and cooperation between partners supports the goals of all parties involved.”

Valdean Severson, audit manager, New Mexico Federal Royalty Audit Unit

AMERICAN INDIAN TRUST

As with its relationship to the states, MMS serves American Indian tribes and individual American Indian mineral owners by ensuring that they receive accurate returns for mineral production on their land. On August 10, 1999, we published a final rule on the valuation of natural gas produced from Indian lands. We are now working on a new rule for American Indian oil valuation.

We take our American Indian mineral trust responsibilities seriously and pay special attention to the unique terms in American Indian leases. We examine these leases to ensure that royalties have been correctly valued according to more rigorous valuation and accounting standards. By the end of fiscal year 2000, we achieved our goals for the percentage of leases in compliance.

While working to guard American Indian mineral interests, MMS also emphasizes American Indian empowerment. **The Navajo Nation is one example of the success of our Royalty Internship Program.**

After working in MRM for nearly two years as an intern, Perry Shirley returned to the Navajo Nation as an auditor.

He is now associate director of the Navajo Nation's Minerals Department and chairman of MMS's Royalty Policy Committee.

This program is customized to each tribe's needs, and provides on-the-job training to help tribes prepare to assume MMS services including revenue accounting, report processing, exception resolution, product valuation and auditing. **Our reengineering initiative is a major part of the Department's high-level implementation plan to improve services to the Indian community.**

As part of our commitment to improve services to American Indian mineral owners, we have established our Indian Compliance and Asset Management office. This office is specifically dedicated to serving mineral producing tribes and individual American Indian mineral owners, and is an advocate for the American Indian community. MMS also provides walk-in service at our offices in Oklahoma and New Mexico.

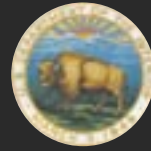


MMS formed an Indian Business Office to provide, on a cost-reimbursable basis, technical support for the Special Trustee for American Indians. MRM will also work on a comprehensive Trust Risk Management Program to help monitor and evaluate the effectiveness of the Department's trust operations.

"Throughout the years since MMS was created, the Navajo Nation and MMS staff have continuously built upon a successful government-to-government working relationship that has experienced many positives and the occasional negative. Today, we can honestly say that this relationship is one in which the Navajo Nation is certainly proud."

Perry Shirley
Chairman, Royalty Policy Committee





All of our work at MMS embodies the best meanings of the term “equity.” From ensuring Americans value for their finite mineral resources to maintaining a fair balance of all our stakeholders’ needs, MMS juggles a host of responsibilities with speed, care and precision. A small agency with a large impact, we never stop looking for the most efficient means to ensure that the nation receives the best value for its precious resources now and in the future.

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